SUPREME COURT, U.S.
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IN THE

Supreme Court of the United States

October Term, 1970

No. 675

COMMERCIAL SOLVENTS CORPORATION,

Petitioner,

v.

THE UNITED STATES.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

PETITIONER'S REPLY TO BRIEF FOR THE UNITED STATES IN OPPOSITION

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The brief for the United States in Opposition is not responsive to the petition for a writ of certiorari. The Solicitor General did not address himself to the two questions presented by petitioner.

Questions Presented

The first question presented by petitioner is directed to amendment of a timely petition in the United States Court of Claims to claim a larger refund than stated in the original petition for the reason that the larger amount was determinable by the Commissioner of Internal Revenue

as a result of facts known to him during the administrative processing of petitioner's original claim for refund. The Solicitor General's restatement of the question infers lack of knowledge by the Internal Revenue Service of petitioner's *intent* to claim the additional refund and ignores *actual knowledge of the facts* by the Service.

The Solicitor General's restatement of the second question ignores so much of petitioner's second question as deals with whether the right sold by petitioner constituted an equitable interest in a manufacturing plant, and whether it was a capital asset.

I.

Amendment of the Petition in the lower Court.

The argument of the Solicitor General that petitioner's reliance on *St. Joseph Lead Co.* v. *United States,* 211 F. 2d 348 (C.A. 2), is misplaced ignores defendant's admitted knowledge that the same operative facts underlie the claim for refund and the amendment of the petition (Pet. 10a). The lower court noted (Pet. 10a): "Defendant further acknowledges that the Internal Revenue Service had knowledge of these facts, and that it considered the accrual question although not in connection with the refund claim." The original claim for refund was for $338,000, or such additional sums as may by law be due (Pet. 39a). The facts of which the Internal Revenue Service had knowledge were known to the service for more than six years prior to the disallowance of the claim and were considered by it in examining petitioner's tax return for the same year (Pet. 41a, 42a). Both the tax return and claim were examined by the same Internal Revenue Agent (Pet. 42a).

The brief in opposition omits all reference to the acknowledged awareness by the Internal Revenue Service of the facts underlying the claim for refund and the amend-

ment of the petition in the lower court. The Solicitor General should be aware, as the lower court was, that petitioner met the requirements of Section 3772(a)(1), Internal Revenue Code of 1939, and that the cases cited by him (Opp. 6, 7) are inapposite.

In *Angelus Milling Co.* v. *Commissioner,* 325 U.S. 293, this Court decided against the taxpayer because the Commissioner of Internal Revenue could only obtain the facts in a roundabout fashion. There was confusing identity of interest. The case involved a claim for refund of AAA taxes paid by Angelus Milling Co., but the claim was filed by and in the name of Niagara Falls Milling Co. and/or Millerport Flour Mills. There the facts were not furnished to the Commissioner expeditiously and accurately. *United States* v. *Felt & Tarrant Co.,* 283 U.S. 269, involved an insufficient claim for refund of 1917 taxes which did not set forth the amount or nature of the claim. *Real Estate-Land Title & Trust Co.* v. *United States,* 309 U.S. 13, involved a claim for refund of taxes based on an erroneous ground. The claim was not amended to assert a proper ground for refund. The taxpayer could not present the proper ground for refund in an appellate court. *Union Pacific Railroad Co.* v. *United States,* 401 F. 2d 778 (Ct. Cl.) does not relate to the issue here. Apparently the Solicitor General meant to refer to 389 F. 2d 437 where Union Pacific Railroad Co. advanced additional grounds for refund not contained in its claim for refund. All of these cases are distinguishable from the present matter.

At page 8 of his brief, the Solicitor General, in a footnote, argued that "recognized accounting principles" support the contention that the entire amount payable was properly includible in petitioner's 1948 income.

The Service recognized that the amount payable consisted of a series of payments due in nine different taxable years (Pet. 36a) and permitted the payor (Mathieson) to

deduct each of the series of payments in the taxable year when each such payment became due (Pet. 45a, 46a). Contrary to the statement in the Solicitor General's brief (page 8), "recognized accounting principles" do not require accrual of income prior to the time that the right to receive the income ripens with certainty. Amounts to be paid do not accrue until there is a fixed and definite liability to make payment. There cannot be one set of "recognized accounting principles" for the payor and another set for the payee in a single transaction. If the point raised by the Solicitor General were meritorious, the liability of Mathieson to make the payments accrued in 1948, and the full amount of the series of payments also should have been deducted by Mathieson in that year. If, on the other hand, Mathieson's liability did not accrue until each payment was due, then petitioner's right to receive all of the payments could not accrue in 1948. The right to receive each of the series of payments accrued only when the liability to make each payment accrued.

Universal Oil Products Co. v. *Campbell*, 181 F. 2d 451 (C.A. 7), certiorari denied, 340 U.S. 850, rehearing denied, 340 U.S. 894, is distinguishable from the present case. In that case the events determining the time of accrual occurred in the year in which a royalty agreement was negotiated. The payor corporation had the option to make payment in four annual installments or in the initial year. It elected to pay in four years and was required to pay interest on the unpaid balance as compensation for the use of *Universal's* money. This case cannot be relied upon as authority to accrue in 1948 all of the payments due from Mathieson.

The contract here, as submitted to petitioner, and as accepted by petitioner, provided for periodic payments of agreed amounts over a period of nine taxable years. The contract contained no provisions for accelerating the pay-

ments under which petitioner could be said to have any unconditional rights to the use of the monies before the specified dates of payment. By the terms of the contract, the liability of Mathieson to make each payment, although determined in 1948, did not become fixed until the due date specified therein. This was recognized by the Internal Revenue Service in permitting Mathieson to deduct each payment in the respective taxable year when it became due.

Washington Post Co. v. *United States*, 405 F. 2d 1279 (Ct. Cl.), is also inapposite. That case involved the deduction of an expense, not the accrual of income. There, obligations to a profit-incentive plan accrued in the years when they were irrevocably credited to a group of circulation dealers which had a vested interest in the plan. The amounts accrued in each year were related to the income of each year. If this case can have any meaning in the present matter it can only support the action of the Commissioner of Internal Revenue in his treatment of Mathieson's deductions which were allowed in the years when the payments were due and those years' production became available to Mathieson. The *Washington Post Co.* case supports the petitioner's contention that both the income and the expense in this matter accrued simultaneously.

The right to receive a payment cannot become fixed prior to the time the payor becomes obligated to pay. *Mertens Law of Federal Income Taxation*, Vol. 2 §12.76 at page 307; *R. H. MacDonald* (1953), T.C. Memo. Op., Dkt. 35526, affirmed on this point, 217 F. 2d 475 (C.A. 6); *Berger Engineering Co.*, T.C. Memo. 1961-292. The dates on which Mathieson became obligated to pay each of the payments in a series were established by contract (Pet. 36a). There was no requirement to make the payments prior to those dates and no payments were accelerated. Petitioner had no right to receive payments prior to those dates and in fact did not receive payments before they were due.

II.

The Capital Gain Issue.

The conflict between the decision of the lower court and the decisions in *Commissioner* v. *Ferrer*, 304 F. 2d 125 (C.A. 2), and *Hollywood Baseball Assn.* v. *Commissioner*, 42 T.C. 234, affirmed, 352 F. 2d 350, vacated and remanded on another issue 383 U.S. 824, results from the failure of the lower court to distinguish between the "tree" and the "fruit". The Solicitor General's argument ignores this important distinction. The Solicitor General claims that the difference between the present case and *Ferrer* rests on the "difficulty of computing damages" (Opp. 10) and he distinguishes *Hollywood Baseball* by asserting that the contract itself in that case was "a going business and as such was property" (Opp. 10).

There is a fundamental error in the Solicitor General's brief of failing to recognize the distinction between the properties in all three cases (Ferrer, Hollywood Baseball and the present case) and the use of those properties that could only result in the receipt of ordinary income. This conclusion disregards the admitted facts that petitioner was not in the business of selling contracts to acquire the production output of a plant, the contract was not included in petitioner's inventory (Pet. 37a) and there was a sale or exchange of property (Pet. 16a).

The Solicitor General ignored the facts in favor of the erroneous opinion of the court below.

CONCLUSION

For the reasons stated above, as well as those stated in the petition for certiorari, petitioner prays that the petition for a writ of certiorari should be granted.

Respectfully submitted,

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